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Exam-style question

Luxury takeovers

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Check your answer to the question on pp. 30–31 of the magazine. This question relates to the AQA specification.

Sample answer

Organic growth is growth within the business, such as new premises, new products or employing more employees to increase production. One benefit of organic growth is that it is less risky than inorganic growth as it means businesses such as Brompton and LVMH don't have to restructure their organisational design. This means they can maintain good internal communication, reducing the impact of diseconomies of scale from increased business size. This would enable the bespoke production of Brompton's folding bikes to remain consistently high, maintaining their high-quality image with customers. This is important to Brompton as they are a multinational corporation (MNC) that operate in many countries such as Japan and the USA and, as they provide a niche product that is tailored to meet customer's individual needs, they can react quickly to any changes in customer tastes and preferences, regardless of the increase in business size due to the processes of communication between disparate markets remaining the same. As a result, as demand increases supply can be constantly met and customers are likely to continue to feel satisfied that the £1000+ folding bike meets their requirements, leading to continued increases in sales and revenue.

Inorganic growth is also likely to allow businesses to deal with any issues resulting from expansion quickly and effectively as lines of communication are already well established, for example, Brompton's 2023 supply issues for components are likely to impact customer orders but effective communication to manage any delays is much less likely to affect their brand image.

For LVMH inorganic growth can be seen in its expansion of the Tiffany brand into China, which accounts for 30% of global LVMH sales. Moving the Tiffany brand 'upmarket' meant significant investment in its New York store as a springboard to launch itself into China, with the hope that such organic growth may allow revenues in new markets will grow significantly, showing that repositioning a current brand can be a significant benefit of organic growth compared to purchasing another brand, often at a greater cost, meaning that the growth objective can be achieved for a lesser outlay of capital.

However, a drawback of organic growth is that it can be much slower than inorganic growth through methods such as mergers and takeovers. This means that competitors may choose inorganic growth to expand faster than companies who use organic growth, potentially gaining a competitive advantage in terms of market share and first mover advantage on new technologies. For example, Tesla achieved first mover advantage in 2019 by taking over tech start-up DeepScale allowing them to embed sophisticated camera and artificial intelligence (AI) systems into their vehicles. These systems built on a previous acquisition in 2013 that allowed Tesla to develop its first self-driving systems. Both takeovers have allowed Tesla to jump ahead of car makers such as Ford, Mercedes and BMW in

semi-autonomous driving systems, with some analysts stating that the company has a 5-year lead in such technology.

Without takeovers it is unlikely that Tesla would have been able to gain such a competitive advantage over competitors. The technology has also allowed Tesla to gather a significant amount of data from its cars to feed into its Dojo supercomputer (the world's fifth fastest computer), which allows the development of more sophisticated AI systems to produce a truly self-driving vehicle. Without inorganic growth it is unlikely that Tesla would be the world's largest car maker by market capitalisation. Inorganic growth contributed to an 18.2% increase in Tesla's profit margins in 2023.

Inorganic growth therefore allows for a range of economies of scale besides the more obvious ones of reducing costs of inputs through bulk buying. Technological economies are at least as important to companies deciding to grow through takeovers and mergers. Tesla's takeover of various technically innovative smaller companies for relatively small amounts of money may have allowed the company to then invest heavily in such technology, enhancing their car offerings so that they can outperform competitors. This has then led to a domino effect of allowing Tesla to use its large revenues to invest further in inorganic growth, such as the so-called Giga Presses, that have created even greater economies of scale, reducing the manufacture of the model Y to 2–3 parts rather than 70. All such advances can be argued to be traced back to judicious takeovers of various technology companies, propelling the business from an unknown automaker in 2012 to one of the world's biggest, and certainly the most disruptive in 2023.

In LVMH's case the horizontal takeover of Tiffany in 2021 for US\$15.8 billion allowed the business to take the already well-established brand from a mid-market brand to a luxury brand, acting as a springboard to grow its sales from US\$14 billion pre-takeover to an anticipated US\$7.5 billion in 2025, due to a significant increase in profit margins and expansion into the Chinese market.

For Brompton undertaking horizontal and vertical takeovers has allowed for economies of scale and cost synergies, such as being able to offer helmets and other accessories that it had no expertise in. As a result, Brompton have been able to take advantage of economies of scale in purchasing its supplies of metal for its bikes and, at the same time, endeared its new products with their niche brand, allowing it to raise its prices on its newly acquired product range. This has led to Brompton being able to charge higher prices for its accessories due to customer perception of the brand as being of higher quality than competitors.

However, inorganic growth can lead to much higher costs, especially in the short term and potential culture clashes across the business. For example, there can be duplication of HR departments or manufacturing facilities, with redundancies and a drop in staff morale and productivity. As a result, this may lead to a loss of quality, which for niche market brands such as LVMH and Brompton may lead to customer dissatisfaction and a loss of revenues as customers turn to other competitors.

In conclusion, both approaches to growth have risks as well as benefits. Businesses need to carefully consider the nature of their market. For example, Tesla operates in a market where technological revolution was not — until recently — the norm. Entry to such an established market required significant competitive advantages to stand any chance of success in terms of growth and even survival.

Inorganic growth, in hindsight, appears to be the only way Tesla could leverage its way into the industry with such a growth strategy appearing to have paid dividends on many fronts, for example, as a first mover in many areas of car development from large screen displays to reliable charging

technologies. Established and higher-volume manufacturers have been left playing catch up. Without judicious use of inorganic growth this would not be the case. However, it's a business's ability to choose the correct growth strategy for their situation that appears to be critical to any growth objective. The ability of entrepreneurs to have a clear long-term strategy is critical to the success of either growth strategy. For example, LVMH's boss Bernard Arnault had a clear plan for growth when the business purchased Tiffany, it wasn't just a simple purchasing of the brand. Therefore, organic and inorganic growth strategies need to have a clear rationale behind them for business to ensure the highest chances of success in terms of overall business growth.

Sample examiner comment

Mark: 25/25 (Level 4 — an excellent response fully focused on the question)

The answer starts with a clear understanding of organic growth and its importance in the objective of growing a business. A depth and range of knowledge and understanding is demonstrated that is precise and well-selected. Analysis occurs throughout and is applied effectively with the use of contextual examples to add depth. The student compares organic to inorganic growth with a perceptive level of application, analysis and evaluation across a range of businesses. The conclusion looks at the wider considerations that affect the choice of organic and inorganic growth, introducing further examples and giving a recommendation as to how a business might make the right choice.

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